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Our Colonial Indebtedness.

BY

A. T. DRUMMOND, B.A., LL.B.

BARRISTER-AT-LAW.

(Reprinted from THE CANADIAN MONTHLY *for December*, 1876.*)*

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OUR PUBLIC INDEBTEDNESS.

BY A. T. DRUMMOND, B.A., LL.B., MONTREAL.

OUR Dominion, Provincial, and Municipal loans, negotiated during the past three or four years in Great Britain, have been of considerable magnitude; and, apart from their immediate, direct results, they have attracted the attention of monied men to the Dominion, and better information now prevails regarding the character and resources of the country. Though the success and continued high character of any individual loan on the London money market may seem to concern only the Province or Municipality which seeks the loan, it is nevertheless true that this success and high character have a wider effect in directing attention to the whole country at large, and indirectly aid in the success of subsequent loans of the other Provinces and Municipalities. It is equally true that the failure of even a single Province or Municipality to meet in London its semi-annual interest, or its maturing bonds, would be long remembered, and would not only affect existing securities of other Provinces and Municipalities, but also render it more difficult to float new issues, especially of localities previously unknown on the money market there. Each Province and Municipality has thus in no small degree an interest in maintaining a high credit for the securities of all the other Provinces and Municipalities, as well as of the Dominion.

Our public indebtedness has arisen from several causes—public works and improvements undertaken by the Government or municipalities; bonuses to railways or other private corporations; and increased educational facilities provided for the people. Thus, the Dominion indebtedness has largely arisen from the Intercolonial and other railways undertaken, and from canals and other improvements; the Province of Quebec's loans of 1874 and 1876 are essentially railway loans; whilst those of our cities have been for such purposes as waterworks, drainage, public buildings and parks, and providing funds for school purposes.

The funded and unfunded debt of the Dominion, including that of each of the Provinces previous to their confederation, was, on 1st July, 1875, $151,663,401. In reduction of this were certain assets, consisting of sinking fund and miscellaneous investments and bank balances, amounting to $35,655,-023, leaving a net indebtedness at that date of $116,008,378. The average rate of interest paid on the funded debt was a fraction over 4½ per cent.

Among the Provinces, since their confederation, Quebec has been the only borrower. Its loans of 1874 and 1876 aggregate $8,030,000, carry 5 per cent. interest, and, so far as issued by its negotiators, are held entirely in Great Britain.

It is difficult to even approximate the municipal indebtedness of the Dominion. In two of the Provinces annual returns are required to be furnished to the Government, showing the indebtedness, by debenture or otherwise, of each city, county, township, and town; whilst in the other Provinces these returns do not appear to be provided for. Only in Ontario have the returns been published. The latest accessible reports for that Province are those for 1872, and in these are some facts of considerable interest when compared with the estimated indebtedness of the present time. One noticeable feature is the large increase in the liabilities of Ontario municipalities during the past three years. This increase has taken place chiefly through affording aid in railway construction; and it is suggestive, judging by the railway projects which have been aided and yet have fallen through, whether the municipalities are not sometimes too easily induced to vote bonuses to, and take stock in, railways. It is doubtful if sufficient consideration is always given to the question whether these railways have such financial resources as will ensure their being completed to the anticipated termini, and whether they are of the alleged advantage to the municipalities through which they pass, and are not, perhaps, only depreciating the value of other lines which run through or near the same districts, by taking away from or sharing with them a traffic not generally large enough for one railway. In 1869 the municipal indebtedness of Ontario is stated by the official reports to have been $15,845,520, including the old municipal loan fund debts. In 1872 this had been reduced to $14,583,800. In the absence of official returns it is difficult to approximate the indebtedness at the present time; but, taking into account the re-arrangement of the municipal loan fund debt, and giving credit for the respective amounts received by certain municipalities under the same Act, which gave effect to that re-arrangement—a considerable part of which amounts were probably devoted to the reduction of heir indebtedness—and further, taking into consideration the bonuses which have been voted to railways, and which either have been or will, in all probability, soon have to be paid, the municipal indebtedness of Ontario now probably exceeds $19,500,000, or an increase of $5,000,000, or thirty-four per cent. in the course of four years. With regard to this increase, it is to be observed that a considerable portion of the railway bonuses paid during that period had been voted by the municipalities previously. These railway bonuses gave rise to a large portion of the new issues of debentures, and the extent to which municipal indebtedness has increased from this source may be judged from the fact that, since the Confederation Act took effect in 1867, the bonuses voted to railways in Ontario by municipalities alone, and quite irrespective of Government grants, have amounted to $6,465,980. Pending the completion of some of the lines, a portion of this amount has not yet been paid. Another feature in this enhanced indebtedness is, that some of the cities and towns of Ontario have added considerably to their liabilities, among others, Toronto, Ottawa, and St. Catharines. In each of these particular instances, however, the greater portion of the increased debt has been incurred on account of water-works, which of themselves form a reproductive asset. The aggregate debenture debts of the cities in 1876 appear to be as follows:—

Toronto	$5,311,810
Hamilton	2,596,049
Ottawa	1,988,122
London	1,150,788
Kingston	470,000

The three cities of Toronto, Hamilton, and Ottawa have thus a united liability of more than one half of the whole municipal debt of Ontario. Some of the counties have, however, also considerable debts. Among them, Huron, Bruce, Middlesex, and Perth have debentures outstanding—chiefly issued in aid of railway construction—which aggregate $2,748,000.

In the Province of Quebec it is not so easy to arrive at approximate returns. The Municipal Loan Fund debt amounts to $2,399,465; and, taking into account the bonuses given to railways and the known liabilities of the cities and towns, the municipal debt of the Province would appear to be in the neighbourhood of $19,000,000. Among the counties, Compton, whilst probably the most flourishing and wealthy, has, in its issue of $250,000 debentures, the largest liability. The city debts appear to be as follows:—

Montreal	$10,488,000
Quebec	3,635,740
Three Rivers	165,000
Sherbrooke	155,000

In the Lower Provinces no official returns are made; but the civic debts are as follows:

St. John, N. B.	$939,164
Halifax	1,213,400

In Manitoba and British Columbia the debts of the capitals are:—

Winnipeg	$250,000
Victoria, B. C.	100,000

The rate of interest which municipal debentures usually carry is six per cent., but seven per cent. is not uncommon. Each municipality knows its own credit sufficiently well to be able, before an issue of debentures takes place, to judge whether it can float six per cents at a figure high enough to make the burden on the ratepayers lighter than if the issue was of seven per cents. It is a mere calculation of compound interest, and a consideration of the credit of the municipality and of what the existing value of money is. There are, however, these decided objections to the issue of seven per cents, that a presumption is at once raised in the public mind that the municipality in question cannot borrow at six per cent., except at a heavy rate of discount under par, and further, in this country, among small issues of debentures, which are necessarily unquoted on the stock exchange, seven per cents rarely rise above par however good the bonds may be, whilst in the case of six per cents the constant aim of sellers and holders is to get them up in value to par. It is better also for a municipality to borrow at six per cent. because as its bonds rise in public favour through the locality and its financial position becoming better known—and every locality should look forward to and aim at this result—any subsequent issues of debentures can be placed at the better figures to which the bonds rise. The reluctance of the public to go beyond par would preclude this being effected in the case of seven per cents. The importance of this question of the rate of interest at which bonds should be issued is measured by the fact that the saving of the single one per cent. in the rate paid on the aggregate indebtedness of the Dominion, Provinces, and Municipalities, estimated at two hundred million dollars, would, taken at compound interest, be a gain at the end of twenty years, of the vast sum of $44,000,000, an amount more than enough to extinguish the entire municipal debts of both Ontario and Quebec.

The rates at which both our Dominion and Provincial Governments, and our cities, can borrow in foreign markets are not as favourable as they might be. The Dominion Government debentures have greatly improved in value during the past few years, and the last issue of Quebec bonds was made at one per cent. better than the previous issue; but the credit of the country is still lower than that of most other dependencies of Great Britain. Thus, the last issue of Canadian Four per cents stood on August 30th at 92½, and Province of Quebec Fives at 100, whilst Victoria Fours were at 99¼, South Australian Fours at 96½, New South Wales Fours 98, Queensland Fours 93½, Natal Fours and one-half 98¼, Cape of Good Hope Fours and one-half 103¾, New Zealand Fives at 104¼, and Victoria Fives 110. The loans issued by the Province of Quebec, both in 1874 and 1876, have been taken up very slowly in London, whilst the recent Queensland loan was subscribed for three times over. It will be readily understood that one reason why the former stand relatively low is that the Province is not as yet well known on the money market. The Dominion has, however, until recently, been prosperous beyond measure, and were it not for influences which may be regarded as in a sense outside, and which yet have their associations with, the country's progress, its bonds should stand as well as those of any other colony or dependency of Great Britain. One of these influences is the financial embarrassments of our larger railways—a chronic complaint of the English investor. It is beyond question that the almost irremediable difficulties of the Grand Trunk Railway, extending as they have over nearly twenty years, have contributed more than any other cause to keep down the values of Canadian bonds. The British investor has come to associate this railway with Canada, and, prompted in the past by the *Times*, *Herepath*, and other English journals, has ascribed not a few of the ills of this railway to the condition of the country. The embarrassments of other lines have helped to deepen this impression. Thus the errors in the original inception and construction of these lines, and the often reckless management since, even though directly controlled by British bond or stock holders, have afforded the occasion for denouncing the country at large. These very difficulties have even given rise to positive opposition to the floating of Canadian loans. The determined and uncalled-for but unsuccessful effort of the *Times* to crush the recently offered Quebec loan betrayed so little of reason, and so much colour of either interest or outside influence or pressure, that it is generally ascribed to the promptings of the President of the Grand Trunk Railway, and of the clique of brokers in London who manipulate Grand Trunk stocks.

There can hardly be a question, unless the loans required for the construction of the Canadian Pacific Railway are gradually issued and judiciously placed on the market, or the Government is successful in securing the construction of the line on the basis of only part cash and the balance land and interest guaranteed, that Dominion bonds will not reach that higher position which Canadians desire to see. The status of these bonds—and the same may be said of the Provincial bonds—depends largely on the watchful care of our Ministers of Finance and our London financial agents, and in this respect not merely in placing the loans at a good figure as they are issued, but by maintaining the credit of the country, by disseminating correct information regarding its resources and prosperity, and by keeping up the prices of the bonds in times of causeless depression by purchases for sinking fund investments and otherwise. It is extremely doubtful if, in the past, this has been always carefully and judiciously done. There seems no reason why the present position of these bonds should not be improved on, and should not be made equal to or even better than that of the bonds of the Australian colonies, if relative population, wealth, resources, and past prosperity form any criterion. New Zealand, with a population, according the census of 1872, of 279,000, has an indebtedness in London alone, according to the London *Economist*, of $69,578,000, or $249 per head of the population; Queensland has a population of 150,000, and a London indebtedness of $28,833,000, or $191 per head; Victoria, with 696,000 of a population is indebted $55,756,000, or $80 per head; whilst the Dominion, whose population was, in 1870, 3,600,000, has a total aggregate funded debt, at home and abroad, of $135,220,000 or merely $38 per head, and with all the municipal and unfunded debts added to this, only $55 per head. From these figures, and a knowledge of this country's resources and wealth, Canadians will judge for themselves whether their finances do or do not require attention.

The powers which our municipalities have of borrowing, under the Municipal Acts of the Province of Quebec, and under the Consolidated Municipal Loan Act, which applied both to that Province and to Ontario, are limited to twenty per cent. of the aggregate valuation of the property in the municipality when the last By-law authorizing a loan is passed. Under the Municipal Institutions Act of Ontario there does not appear to be such a limitation; but municipalities are restricted from contracting debts which would require a greater rate to be levied than an aggregate of two cents on the dollar annually on the actual ratable property. It would be better for the credit of all municipalities, and would result in a wider market and a better price for their bonds, if not only there were such a limitation in every Province, but also if the limit did not exceed ten per cent. of the aggregate valuation of the property in the municipality. It is not an unfrequent circumstance to hear English investors refer to the fact that five per cent. is a common limit in such cases in the United States, and contrast it with the more extended powers conferred on Canadian Municipalities. This is a matter which, in the interest of the country at large, should receive the attention of the Government.

In each case, excepting where a By-law passed by a city council affects Local Improvement Debentures, which are necessarily limited in amount, and where, passed by a County Council, the proposed loan is for a sum not exceeding $20,000, every By-law, before it can have any legal effect, must, after due public notice, receive the assent, by public vote, of the ratepayers of the municipality. Further, under the Municipal Acts of the Province of Quebec, the assent of the Governor in Council to the By-law is necessary, and proof is required to be then made that the requirements of the law have been fully met. Though a similar assent of the Governor in Council is not stated in express terms to be necessary under the Act regarding Municipal Institutions of Ontario, although it was under the Municipal Loan Fund Act, such assent is expressly required to every By-law intended to in any way alter or repeal such previously passed By-law authorizing a debt to be incurred. All these limitations and requirements are very important sources of confidence to bondholders, as virtually every debenture liability incurred is required to receive the assent of three tribunals—the Municipal Council, the ratepayers affected by it, and the Governor in Council—and, further, the aggregate indebtedness cannot exceed twenty per cent. of the security, or must be such as not to require a rate of assessment exceeding two cents on the dollar for all purposes.

It is, by the Municipal Acts of both Ontario and Quebec, made a condition precedent to the legality of any By-law authorizing the issue of debentures, that a sinking fund shall be provided for in the By-law. In the Province of Quebec, and virtually under the Municipal Loan Fund Act, this sinking fund is arranged by an annual rate of two per cent; whilst in Ontario it is required, in general terms, that an annual special rate shall be levied for paying the interest and creating an equal yearly sinking fund for paying the principal. Municipalities in Ontario are permitted to make a certain proportion of the bonds fall due annually, until, at the expiration of the term, the whole debt—principal and interest—is paid off. This latter plan is advantageous in some respects to the municipality, as it compels the corporation to invest annually in its own bonds, in preference to other investments, thus gradually reducing the indebtedness of the municipality, and removing the liability to possible loss through investments in other securities. The plan is, however, objectionable in other respects, as each set of bonds payable in any one year has a different value from those payable in other years, rendering the bonds thus more difficult of sale, both at first and subsequently. When the loan is very large, it would be impossible to obtain a stock exchange quotation for debentures issued on this plan; and this would be a very serious objection, as it would narrow the circle of buyers to permanent investors only, and but few of them would be purchasers, as even a permanent investor requires to consider the possibility of his having to realize at some future time, and on an unquoted bond it might be almost impossible at such a juncture either to realize or to obtain advances. To the uninitiated, the value of a stock exchange quotation may not be apparent, but such now are the modes of transacting business that this quotation has become a necessity, in order that the particular stock or bond may be constantly before the public, who thus become familiar with its value from day to day, and in order that sellers may at any moment be able to dispose of what they hold. The proper plan for any province, county, or city issuing a large loan, and desirous of paying off a proportion every year, is to make all the bonds payable at one definite time, and to provide for annual drawings by lot of so many bonds as it is desired to redeem. No bondholder knows when his particular bonds may be drawn and paid off; and, therefore, the whole bonds issued have the same value.

An error into which two or three of our municipalities have fallen, is that of bringing out on the English market successive loans within short periods of each other. It is always more to the advantage of a Province or municipality negotiating a loan to anticipate its wants, if possible, and combine them in one issue of debentures. It may be thought that investors will look only at the aggregate indebtedness, but this is far from being the case. So sensitive are the monied public that loans, however good they are, and however small each individually may be, are viewed with some degree of suspicion when they follow each other in quick succession. That each as it comes out is not to be the last becomes the public impression. But apart from this it is to be borne in mind that, in a vast monetary centre like London, a large loan, if really good, will always be more successful than a small one. It is, in fact, well known that the best financiers in London do not care to undertake the negotiation of loans under £100,000 stg.

It is well that discernment and prudence should be shown by municipalities in exercising their powers to issue debentures. There may be occasions when, with the money market unfavourable, public confidence unsettled, or previous issues of bonds at a discount, it would be very impolitic to offer a fresh issue to the public, besides being an injustice to existing bondholders by further depreciating the value of their securities. Were the people of each municipality, who certainly know and should have faith in its resources, always ready, as they are in Great Britain, themselves to take up the bonds of their own municipalities as they are issued, there would not be the most remote possibility of any such municipality being allowed to incur an unreasonable indebtedness. As yet there is not wealth enough in the country to do this, and a very large part of each municipality's indebtedness is in reality held outside of the municipality; in the case of Canadian cities is chiefly held in Great Britain. Now the measure of confidence which the public have in a bond is the measure of its value in the money market. It is, therefore, of the utmost importance that such holders of Canadian municipal bonds, living as they do at a distance, and having fewer sources of information than residents, should have no colour of reason afforded them for in the least doubting the resources of the municipalities, and of their ability to meet their indebtedness. The trans-Atlantic investing public are very nervous lest there should be over-issues of bonds, and lest our cities and provinces should incur more liabilities than they are able to bear. New loans recently placed, and rumours of fresh loans, as well as other exciting causes, have recently occasioned very serious falls in the values of the debentures of two of our Canadian cities on the London Stock Exchange. We are further told—with much exaggeration however—by one whom the London *Times* terms a leading shareholder of the Grand Trunk Railway, that at present Canadian city bonds are almost unsaleable in the English market. Every Canadian will be ready to affirm, and with good reason, that there are in reality few better securities quoted on the London Stock Exchange than Canadian municipal bonds, and every banker in this country is aware of their unexceptionable security. The depreciation in these particular cases proves how sensitive the British investing public are. The effect of the depression in these bonds is that not only will any projected loans of these cities, if issued now, whether here or in London, require to be sold at a considerable discount, and perhaps with difficulty, but their previously placed securities may be still further depressed whenever such fresh issues take place, and all Canadian municipal bonds in the English market will be more or less affected.

The debenture debt of any province or municipality, held as it always more or less is by trust and other corporations, and by individuals living beyond its limits, should be regarded as the most sacred obligation which the province or municipality has. The debentures and the coupons attached are its promissory notes, and the promptitude or carelessness with which these are met enhance or lower its reputation and credit. States, provinces, and municipalities, like individuals, have a reputation to maintain or lose, though they differ from individuals in this respect, that this reputation once lost is not easily regained. The default of a state, province, or municipality is, through the public press, heralded everywhere, and frequently referred to in after years, in the course of political as well as commercial and financial allusions to the country; and this default is the more serious because of its lowering effect on the securities of integral parts or other sections of the country. Some years since one of our Canadian municipalities, whose position is now above question, allowed its securities to go to default, and every holder of Canadian bonds who has endeavoured to float them in Great Britain is aware how inimical to the best existing and future interests of that municipality the default has been, and how much it has impeded the negotiation of other Canadian loans. The remedy, however, which bondholders have in cases of such default, under our Canadian municipal laws, is clear. In every municipality the ratepayers and their property are liable to assessment to meet the indebtedness under the bonds, and on a judgment obtained and writ issued, the Sheriff will make such assessment and levy the taxes under it.

In the United States, State securities are, as a rule, not held in such high esteem as they should be, considering the wealth and resources of the individual States themselves. Rhode Island six per cents are at present 106, Michigan sixes, 104, those of Illinois 101, and those of Missouri 106. On the other hand, on the London Stock Exchange, Province of Quebec five per cents are at par. For this disparity in price there is, however, among others, one very obvious reason. The Eleventh Amendment to the Constitution of the United States enacts that the judicial power of the United States shall not "extend to any suit in law or equity commenced or prosecuted against one of the United States by citizens of another State, or by citizens or subjects of any foreign state." Under the protection of this amendment, States have continued free from prosecution, and state bonds have become virtually mere debts of honour. Alluding to this subject, Mr. Reverdy Johnson, formerly United States Minister to England, has said: "It has often been regretted, and I think with good reason, that such an amendment was ever made. The consequence has often been most unjust to individuals, to the cause of justice, and to the interests of States themselves. To the States, because it has frequently induced them to enter into reckless engagements under the confidence that their compliance cannot be enforced, and this has frequently resulted in injury to their reputation, as well as in wrong to the citizen."

Municipalities should themselves undertake the negotiation of their debentures, and, as far as possible, themselves fix their value in the market. They are the most deeply interested in maintaining their municipal credit, and, therefore, in obtaining the best ruling prices for their own securities. Too frequently, when bonuses have been given to railways, the debentures have been simply handed over to the railway company, to be in turn transferred to the railway contractors, who, often pressed for means with which to carry on the work of construction, sacrifice the debentures for whatever they will bring. It thus happens that municipalities which have but small indebtedness, and which have always been prompt in meeting their obligations, and whose credit should be unexceptionable, find their securities sometimes heavily depreciated.

Municipalities require also to exercise care in the choice of the bankers or brokers who issue their loans for them. Hitherto some of our city corporations appear to have thought, when making a loan on the English market, that the price to be received for their debentures was the only subject for consideration. Three of them have, on different occasions, sold their securities to a firm of sharp, unprincipled financiers, who for some years have been known to be unworthy of confidence, and with whom respectable bankers would have no association. As in all their other schemes, this firm of financiers took no further interest in the loans, or in the cities which issued them, than was required to make a margin of profit on the negotiation of the debentures on the London market. Unfortunately for the credit of these cities, the name of this firm has become so associated with their loans on that market, that there are numerous firms of English and Scotch bankers, brokers, and solicitors, who, for that sole reason, would neither touch nor recommend to their customers or clients the securities of these cities. A serious result is the greater difficulty in floating fresh loans, and a diminished range of circulation for existing securities there. There is, however, another light in which to view the whole matter. Respectable bankers take an interest in, and carefully watch, the position in the money markets of the loans which they have issued. If unfounded rumours prevail lowering the price of the bonds, they endeavour to correct these rumours and restore the confidence of the public. Naturally they have an anxiety to maintain the price, because they feel that their own good name is associated with their loans. Some bankers have gone farther than even this, and a notable instance which was spoken of everywhere in monied circles in England to the honour of the firm which did it, has occurred within the last few months. The semi-annual interest on a certain large American loan fell due in London last spring, and was unprovided for, when Baring Brothers, who had floated the loan, gave prompt intimation to the bondholders to send in their coupons as usual for payment, and provided for them themselves.

At the present moment, city of Quebec six per cents, which a few months since were as high as 103 ex dividend, have fallen to 91½, and were even as low as 90½, and Ottawa six per cents, which were equally high but a short time ago, have receded to 95. It is to be feared that Grant Brothers, who have issued all the loans of these cities, would not, under any circumstances, have treated them differently from Emma Mine and Lisbon Tramways loans; and at the present time, if these cities desire to restore confidence in their securities, they must employ some other medium than a firm whose reputation is gone.

The state of the civic finances has lately been engaging serious attention in more than one Canadian city—the result perhaps, less of increased taxation, though that in some cities has been heavy enough, than of the greater economy felt necessary and practised in every household, consequent on the protracted depression in trade. Whether a curtailment of civic expenditure will result, it is difficult to determine, as discussion in such cases usually unveils the fact that certain expenditure has been authorised and must be met by taxation, and then, the taxes once paid, the public relapse again into indifference, from which they probably will not be aroused until the tax-gatherer once more makes his appearance. There can be no question as to the indifference with which the civic expenditure appears to be regarded in most of our cities, and it is indicative of the indifference, and results from the intensity with which party warfare is waged, that whilst an expenditure of fifty thousand dollars, the propriety of which it was possible to question, could not be made by the Government at Ottawa without the whole country being made aware of it by editorials in the public press, an expenditure of a similar sum by a civic corporation would often scarcely be known to any one who did not read for himself the City Council reports. At the end of the civic year the ratepayers are alarmed at the amounts of the taxes which they have to pay; but are they not themselves in part to blame? It is to be hoped, however, that some reform will result from the discussion. Cities and towns, as well as private individuals, must contract their expenditure when the necessities of the times require it. It is of as much importance, and even more, to the one as to the other, to maintain its credit. Municipal corporations must realize the fact that their expenditure must be measured entirely by their income, and their public indebtedness by the permanent advantage resulting from the expenditure of the moneys borrowed, and by the perfect ability and willingness of the ratepayers to pay the interest and sinking fund. The temporary expedient, but financial fallacy, of having a floating debt, which generally in the end has to be provided for by a new issue of bonds, must be done away with; the idea that debts of whatever nature can always be disposed of by such new issues of bonds must be dissipated; sinking funds must be more carefully guarded in the hands of trustees, and more carefully re-invested than in some cases they have been; and corporations must have it brought home to them that however advantageous the object may be, to carry out which they at any time desire to borrow, they can never place their loans to the best advantage unless there is the greatest confidence placed by the public in the cautious and economical management of their finances.